



Large Cap Value Strategy



Dmitry Khaykin
Managing Director,
Portfolio Manager



Deepon Nag
Managing Director,
Portfolio Manager

Key Takeaways

- ▶ Two-thirds of the benchmark Russell 1000 Value Index's 13.9% gain came from the information technology (IT) sector, led by a surge in memory semiconductor and optical/networking stocks.
- ▶ Extreme risk taking in the market has led to a large selloff in the high-quality defensive stocks that make up the backbone of our portfolio.
- ▶ We are using the reset in quality and defensive stocks to upgrade the portfolio, while doing the work on the narrower AI supply-chain businesses where the facts may have changed.

Market Overview

U.S. equities rebounded in the second quarter amid de-escalation of Middle East tensions and a rotation back into AI stocks. Two-thirds of the benchmark Russell 1000 Value Index's 13.9% gain came from the information technology (IT) sector, led by a surge in memory semiconductor and optical/networking stocks. This very narrow market made it a challenging quarter for a diversified portfolio of higher-quality stocks, and after outperforming in the first quarter of 2026 we trailed the Russell 1000 Value in the second quarter.

Underperformance came from not owning, or being underweight, this narrower group of commodity-sensitive businesses in the memory, optical and electronic manufacturing services space whose earnings power has been repriced very quickly. Historically, these have been low-quality commodity businesses that posted negative profitability during the past downturn. We don't believe "this time is different," and we expect these businesses will experience similar (or worse) fates as new supply comes online in the 2027/2028 timeframe.

While we didn't have exposure to these lower-quality AI stocks, we continue to hold AI-exposed companies with much more durable franchises. For example, Taiwan Semiconductor and Broadcom were both positive contributors as their technologies remain best in class and demand continues to exceed supply. Intel also continues to prove out its turnaround plan as its foundry business appears poised to gain new customers as soon as 2027, and its leading server CPU business is sold out as agentic AI drives more demand for general purpose compute.

We would also note that this extreme risk taking in the market has led to a large selloff in the high-quality defensive stocks that make up the backbone of our portfolio. Given the lower inherent volatility of these businesses, we believe strongly that they will produce superior

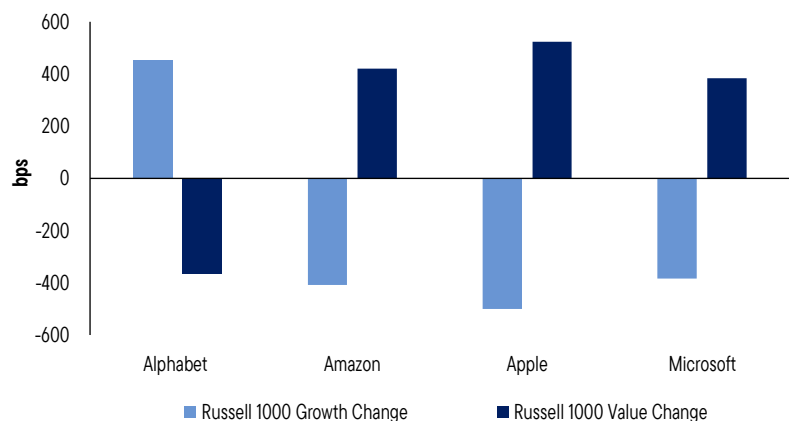
through-cycle returns, and we have been aggressive in adding to stocks that we believe are trading well below their intrinsic value.

Portfolio Activity

We added two new names in the quarter and exited three. In industrials, Eaton is enjoying strong fundamentals and high demand from data centers for its electrical equipment; it has a large backlog for which it keeps adding capacity. Shares have been sluggish in the past year, but we believe capacity coming online should lift top- and bottom-line growth for the company, benefiting stock over the medium term. We funded the purchase of Eaton with sales of Boeing (a marginal position after a previous trim to fund our purchase of Honeywell International earlier in the year) and Illinois Tool Works, compared to which we prefer Eaton's higher growth in the industrial recovery.

We also added Apple: the stock was added to the Russell 1000 Value Index in a rebalancing that was more impactful than usual (Exhibit 1). Apple is a high-quality, durable franchise with strong free cash flows and a robust balance sheet, and the addition helps our efforts to upgrade portfolio quality and lower balance sheet leverage in an environment of inflation and interest rate concerns. Interest rate sensitivity drove our decision to exit American Tower in the quarter, for example, as the communications tower operator's high leverage becomes a risk amid persistent inflation.

Exhibit 1: Significant Mega Cap Benchmark Changes



Changes measure weighting of each stock on June 26 in each index. Source: FactSet.

Both Microsoft and Amazon became major constituents in the value benchmark as a result of June 26th rebalancing. As a matter of fact, the rebalancing resulted in over 20% turnover in the benchmark: one of, if not the, highest instances on record. Sticking to our disciplined, fundamentals-first process, we added to both these holdings at what we consider reasonable valuations; we like Microsoft's strong balance sheet and cloud exposure and Amazon's competitive advantages in both e-commerce and cloud/AI. Meanwhile, we trimmed our positions in Intel and Broadcom as market exuberance reflected what could be cyclical peaks for their industry, and we are cognizant of the material

reduction of semiconductor exposure as a result of the value benchmark rebalancing, which requires prudent risk management.

Outlook

The opportunity coming out of the quarter, in our view, is not to chase everything that worked. It is to use the reset in quality and defensive stocks to upgrade the portfolio, while doing the work on the narrower AI supply-chain businesses where the facts may have changed. That is an optimistic set-up for our process because prospective returns have improved in the kinds of companies we generally want to own.

The portfolio response is offensive, but still quality-first. We are leaning into areas where valuation, balance sheet strength and earnings durability are improving, including select life sciences tools, managed care, industrials and AI-adjacent businesses with credible free cash flow.

At the same time, we are not abandoning the Strategy's discipline. The companies we want to own should have durable competitive advantages, pricing power, strong balance sheets and the ability to compound through the cycle. Where a business still depends on commodity pricing, aggressive supply assumptions or peak-cycle margins, we need to be paid for that risk.

Put differently, we want to be more aggressive because the starting point is better, while keeping the hurdle rate for portfolio inclusion high. The work now is to separate genuine franchise improvement from cyclical earnings momentum, add to quality businesses that have been indiscriminately sold and only expand in AI supply-chain names where normalized returns justify the risk. That is a good setup for our process.

Portfolio Highlights

The ClearBridge Large Cap Value Strategy underperformed the benchmark Russell 1000 Value Index for the quarter. On an absolute basis, the Strategy had positive contributions from eight of 11 sectors. The IT, financials and health care sectors were the main positive contributors, while energy was the main detractor.

In relative terms, overall stock selection and sector allocation detracted. Stock selection in IT and industrials, an IT underweight and overweights to materials, health care and energy detracted the most. Conversely, stock selection in communication services and health care and underweights to consumer staples and communication services contributed the most.

On an individual stock basis, the biggest relative contributors during the quarter were Intel, Taiwan Semiconductor, CVS Health, Microchip Technology and not owning Walmart. The biggest detractors were ConocoPhillips, McKesson and not owning Micron Technology, SanDisk and Advanced Micro Devices.

In addition to the transactions mentioned above, we received shares of Honeywell Aerospace in the industrials sector following its spinoff from holding Honeywell International.

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